

## Internal Revenue Service

Department of the Treasury  
Washington, DC 20224

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Person To Contact:  
, ID No.

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Refer Reply To:  
CC:PSI:B01 – PLR-100831-08  
Date:  
June 18, 2008

X =

A =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Trust 1 =

Trust 2 =

Trust 3 =

Dear :

This responds to a letter dated December 21, 2007, submitted on behalf of X, requesting a ruling under section 1362(f) of the Internal Revenue Code for an inadvertent termination of an S corporation election.

Facts

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X elected to be treated as an S corporation for federal tax purposes, effective Date 1. On Date 2, A, a shareholder in X, died. Under the terms of A's will, at the time of A's death, the shares of X transferred to Trust 1. Because no election was made to treat Trust 1 as an Electing Small Business Trust (ESBT), X's S corporation election terminated on Date 3.

On Date 4, Trust 1 transferred its shares of X to Trust 2 and Trust 3. The current income beneficiary of Trust 2 did not timely file the appropriate election under section 1362(d)(2) to treat Trust 2 as a Qualified Subchapter S Trust (QSST). In addition, no election was made to treat Trust 3 as an ESBT.

X represents that there was no intent to terminate X's S corporation election. X also represents that the failure to file timely the ESBT elections for Trust 1 and Trust 3 and the failure to file timely the QSST election for Trust 2 was not motivated by tax avoidance or retroactive tax planning. X represents that Trust 1 and Trust 3 each comply with the requirements under section 1361(e), which defines an ESBT, and that Trust 2 has complied with the requirements under section 1361(d), which defines a QSST.

X and its shareholders agree to make any adjustments required by the Secretary consistent with the treatment of X as an S corporation.

### Law and Analysis

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under section 1362(a) is in effect for such year.

Section 1361(b)(1) defines a "small business corporation" as a domestic corporation which is not an ineligible corporation and which does not (A) have more than 75 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in section 1361(c)(2), or an organization described in section 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1362(d)(2)(A) provides that an election under section 1362(a) shall be terminated whenever (at any time on or after the first day of the taxable year for which the corporation is an S corporation) the corporation ceases to be a small business corporation.

Section 1361(d)(1) provides that a QSST whose beneficiary makes an election under section 1362(d)(2) will be treated as a trust described in section 1361(c)(2)(A)(i),

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and the QSST's beneficiary will be treated as the owner (for purposes of section 678(a)) of that portion of the QSST's S Corporation stock to which the election under section 1361(d)(2) applies. Under section 1361(d)(2)(A), a beneficiary of a QSST may elect to have section 1361(d) apply. Under section 1361(d)(2)(D), this election will be effective up to 15 days and two months before the date of the election.

Section 1361(d)(3) defines a QSST as a trust (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only one income beneficiary of the trust; (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary; (iii) the income interest of the current beneficiary in the trust shall terminate on the earlier of the beneficiary's death or the termination of the trust; and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to that beneficiary; and (B) all of the income (within the meaning of section 643(b) of which is distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States.

Section 1361(c)(2)(A)(iii) provides that for purposes of section 1361(b)(1)(B), a trust, with respect to stock transferred to it pursuant to the terms of a will, but only for the 2-year period beginning on the day on which such stock is transferred to it, may be an S corporation shareholder.

Section 1361(c)(2)(A)(v) states that an ESBT is a permissible shareholder of an S corporation.

Section 1361(e)(1) defines an ESBT, in part, as a trust if --

(i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in paragraph (2), (3), (4), or (5) of section 170(c), or (IV) an organization described in section 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary,

(ii) no interest in such trust was acquired by purchase, and

(iii) an election under this subsection applies to such trust.

Section 1361(e)(3) provides that an election to be an ESBT shall be made by the trustee. Any such election shall be applied to the taxable year of the trust for which made and all subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1362(f) provides, in relevant part, that if (1) an election under section 1362(a) by any corporation was not effective for the taxable year for which made (determined without regard to section 1362(b)(2)) by reason of a failure to meet the requirements of section 1361 (b) or to obtain shareholder consents, (2) the Secretary determines that the circumstances resulting in such termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in ineffectiveness, steps were taken so that the corporation is once more a small business corporation, and (4) the corporation and each person who was a shareholder of the corporation at any time during the period specified pursuant to section 1362(f), agrees to make any adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to the period, then, notwithstanding the circumstances resulting in the ineffectiveness, the corporation shall be treated as continuing to be an S corporation during the period specified by the Secretary.

### Conclusion

Based solely on the representations made and the information submitted, we conclude that X's S election terminated on Date 3 because the trustees of Trust 1 failed to timely file and complete the required ESBT elections under section 1361(e)(3). We further conclude, however, that the termination was an inadvertent termination within the meaning of section 1362(f). Moreover, had X's S corporation election been valid, it would have terminated when shares of X were transferred to Trust 2 and Trust 3. We conclude that this termination would have been inadvertent within the meaning of section 1362(f).

Pursuant to the provisions of section 1362(f), X will be treated as continuing to be an S corporation on and after Date 3, unless X's S election is otherwise terminated under section 1362(d), provided that the respective trustee files an ESBT election with the appropriate service center of the date of this letter for Trust 1, effective Date 3, for Trust 3, effective Date 4, and for the income beneficiary of Trust 2 file an election to treat Trust 2 as a QSST, effective Date 3. These elections must be filed within 60 days of the date of this letter. This letter is conditioned on Trust 1, Trust 2 and Trust 3 filing any amended returns that are necessary to comply with this ruling. A copy of this letter should be attached to the ESBT and QSST elections.

Except as specifically set forth above, we express no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed on: (1) Whether X is otherwise eligible to be treated as an S corporation; (2) Whether Trust 1 and Trust 3 are eligible ESBTs under section 1361(e); and (3) Whether Trust 2 is an eligible QSST under section 1361(d)(3).

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

*David R. Haglund*

David R. Haglund  
Senior Technician Reviewer  
Office of Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy for ' 6110 purposes

cc: